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Argument

1 UNITED STATES DISTRICT COURT  
2 SOUTHERN DISTRICT OF NEW YORK

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3 AMBAC ASSURANCE CORPORATION,  
4 et al.,

Plaintiffs,

v.

12 Civ. 7937 (MGC)

6 CAPITAL ONE, N.A.,

7 Defendant.

8 -----x

9  
10 New York, N.Y.  
11 March 7, 2013  
12 10:30 a.m.

13 Before:

HON. MIRIAM GOLDMAN CEDARBAUM,

District Judge

14 APPEARANCES

15 PATTERSON BELKNAP WEBB & TYLER LLP

16 Attorneys for Plaintiffs

17 BY: PETER W. TOMLINSON

18 HENRY J. RICARDO

BENJAMIN LITMAN

19 FOLEY & LARDNER LLP

20 Attorneys for Plaintiff Segregated Account

21 BY: JEFFREY SIMMONS

22 MURPHY & MCGONIGLE PC

23 Attorneys for Defendant

24 BY: JAMES A. MURPHY

25 JAMES K. GOLDFARB

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1 THE COURT: This is a motion to dismiss a complaint.  
2 Why don't I hear first from the proponent of the  
3 motion.

4 MR. MURPHY: Thank you, your Honor.

5 Good morning. My name is James Murphy. I represent  
6 Capital One. This is my first appearance before the Court on  
7 this matter.

8 We have brought a motion to dismiss. We worked very  
9 hard to try to refine the issues, and I think there are really  
10 two issues for the Court to decide with respect to our motion.  
11 Before I address those issues, if I could just set the stage a  
12 little bit. I represent Capital One.

13 THE COURT: Capital One is located in northern  
14 Virginia?

15 MR. MURPHY: It is. It is right on the Beltway. Its  
16 corporate headquarters is in McLean, Virginia.

17 Capital One acquired Chevy Chase Bank in 2009. Chevy  
18 Chase Bank originated loans and put together six securitization  
19 trusts in the 2006 and 2007 time period and AMBAC, the  
20 plaintiff in this case, insured portions of those deals.

21 THE COURT: Right. This was not a typical banking  
22 transaction clearly. That was a sale of securities, isn't that  
23 right?

24 MR. MURPHY: Securitizations are very, very common.  
25 So I am not sure what --

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1 THE COURT: I understand they are common. But they  
2 are not banking functions really, but that is a separate issue.

3 MR. MURPHY: Well, a lot of banks achieve --

4 THE COURT: For the last ten years everybody has wants  
5 to sell securities and everybody wants to back them with  
6 mortgages.

7 MR. MURPHY: Your Honor, that is exactly why I wanted  
8 to set a little bit of the background here. I fully understand  
9 that on our motion to dismiss we must accept all of the  
10 well-pleaded factual allegations as true for purposes of the  
11 motion, but just simply by way of background Chevy Chase Bank  
12 in some form or another has been around since 1892, when it was  
13 founded.

14 THE COURT: Right. As a bank.

15 MR. MURPHY: It was a bank, and mortgage was a big  
16 part of what it did.

17 THE COURT: I understand.

18 MR. MURPHY: The reason I bring that up is simply  
19 because there is a lot of publicity and press about cases  
20 involving companies that I consider to be very different from  
21 Chevy Chase Bank, which is a bank.

22 THE COURT: I understand. But not very different  
23 transactions if they are mortgage-backed securities. I can't  
24 tell you how many I have had in the last few years for  
25 securities fraud.

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1 MR. MURPHY: The transactions were very simple. The  
2 difference is this is a bank with underwriters who work at the  
3 bank, and these underwriters underwrite loans. Some of them  
4 were held on the balance sheet, some of them go into  
5 securitization trusts.

6 It is a little bit different from other companies that  
7 I won't name that have a very different business model, banks  
8 with branches, and underwriters who are trained underwriters by  
9 the bank underwrite loans that are held by the bank as well as  
10 loans that go into securitizations. So I simply wanted to  
11 point out that this may very well be a very different category  
12 and may explain why these loans --

13 THE COURT: But this is a suit for breach of contract.

14 MR. MURPHY: Right.

15 It may explain why these loans performed very well  
16 through the financial crisis.

17 So I said there were two issues on our motion to  
18 dismiss. The first issue is, is the repurchase remedy the sole  
19 remedy for the claims alleged in this case. That is issue  
20 number one.

21 Issue number two is, what is the universe of loans  
22 that will be at issue in this case. Is it the loans for which  
23 AMBAC has given notice to Capital One, which are 1286 loans, or  
24 is it the full universe of all of the loans in these deals, for  
25 which no notice has been given?

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1 THE COURT: All of that depends on the language of the  
2 contract.

3 MR. MURPHY: Exactly. Precisely.

4 So that is why courts have found that it is  
5 appropriate to address these two issues on a motion to dismiss.  
6 There aren't extraneous factual issues that will impact the  
7 answers to these two issues.

8 THE COURT: Provided the contracts are unambiguous.

9 Isn't that right?

10 MR. MURPHY: Exactly. That is absolutely right. And  
11 these are long and sometimes complicated contracts for sure.

12 So I will address the first issue first. There are  
13 two contracts. One is referred to as the PSA, the purchase and  
14 sale agreement; and the other is called the INI, the insurance  
15 and indemnity agreement. Those are the two contracts that are  
16 at issue in this case, and both sides have briefed about those.

17 The PSA provides that in the event there is a breach  
18 of a representation or warranty about a mortgage loan that  
19 materially and adversely impacts the interests of the insurer,  
20 and that is AMBAC, the plaintiff in this case, then they may  
21 seek to give notice to Capital One to repurchase the loan, and  
22 if in fact there is a breach that materially and adversely  
23 impacts the interests of the insurer, then Capital One is  
24 obligated to repurchase that loan.

25 And it further says that is the sole remedy for

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1 breaches of reps and warranties about those loans. And that is  
2 what this case is about. So there are some attempts, I think,  
3 to end run that sole remedy provision, and AMBAC is seeking  
4 general contract damages separate from the sole remedy that is  
5 provided for in the contracts.

6 So why do they believe that's OK?

7 Number one, they say and allege that there are  
8 pervasive breaches of the reps and warranties in these loans  
9 that are in the six trusts that are at issue in this case.

10 The way they get there is they say they hired a  
11 third-party reunderwriter to take a fresh look at the loan  
12 files to determine whether there are breaches. The important  
13 thing to understand, your Honor, is this happened after the  
14 greatest financial crisis since the Great Depression. And  
15 there were massive defaults in mortgages because unemployment  
16 spiked over 10 percent, the value of homes crashed. People  
17 walked away from loans, walked away from their homes because  
18 they owed more than the house was worth or they lost their job,  
19 and that happened by the millions.

20 So we saw throughout this economy unprecedented  
21 defaults. So AMBAC had provided an insurance policy that  
22 guaranteed the payment of principal and interest to the  
23 investors in the trusts. And because loans in the trust  
24 experienced this increased unexpected level of defaults, they  
25 were called upon to make good on their insurance.

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1           Now, they haven't. They have not paid on their  
2 insurance anything. The reason is AMBAC went into what is  
3 called rehabilitation in the state of Wisconsin, and so the  
4 insurance commissioner of the state of Wisconsin has taken over  
5 AMBAC, and I'm not using the technical terms.

6           THE COURT: No, of course.

7           MR. MURPHY: But they are running the show now, and so  
8 one of the things that happened is they got an order saying  
9 they don't have to make any other payments on the policies. I  
10 feel like Marco Rubio.

11           So they are seeking damages, but they have none. That  
12 is really beside the point. The sole remedy, to get back to  
13 the sole remedy --

14           THE COURT: When you say they have none, you mean they  
15 haven't paid anything yet?

16           MR. MURPHY: That's correct.

17           THE COURT: It is premature?

18           MR. MURPHY: That is true. It is.

19           But, in any event, their argument is they're  
20 pervasive. And they use this company to say, Here, we've got  
21 this tremendous exposure on our insurance policy, figure out  
22 some way to come up with breaches so we can try to start  
23 putting back loans to Capital One.

24           That's what I believe happened. But, in any event,  
25 so, they say it's pervasive. It's all over these loans. It is



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1 not just --

2 THE COURT: What proportion of the loans turned out to  
3 be bad loans?

4 MR. MURPHY: Well, your Honor, I am not exactly sure  
5 what you mean by bad loans. If you think about it --

6 THE COURT: Where the homeowner was unable to pay the  
7 mortgage is what I mean.

8 MR. MURPHY: Because they had, let's say an 800 FICO  
9 score, took out a loan, and had a great job paying a lot of  
10 money and --

11 THE COURT: I understand. But that is not my  
12 question. My question is how many people did that happen to?

13 MR. MURPHY: -- and three years later they lost their  
14 job and could no longer pay the loan, is that a bad loan?  
15 Actually, it is a good loan. And it is an unfortunate thing  
16 that has happened to people in our country that they found  
17 themselves in that position.

18 THE COURT: I am not quibbling over words. Which of  
19 the loans were unable to be repaid?

20 MR. MURPHY: They have a chart in the complaint --

21 THE COURT: What proportion of those?

22 MR. MURPHY: -- which shows different.

23 THE COURT: I understand. But why don't you give me  
24 an idea.

25 MR. MURPHY: I think it ranges, my recollection is it

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1 ranges from 18 to somewhere in the mid 30 percentage. And  
2 these loans were adjustable rate mortgages. They were called  
3 option ARMs.

4 THE COURT: The bank was not giving the mortgages?

5 MR. MURPHY: Yes.

6 THE COURT: Oh, it was.

7 MR. MURPHY: Yes.

8 THE COURT: Have they adjusted the mortgages?

9 MR. MURPHY: The rates adjust according to the terms  
10 of the loans, which change from time to time. These  
11 underwriting guidelines are not static, but, yes, the loans  
12 adjust. They are adjustable rate mortgages. And those  
13 mortgages were more susceptible to defaults across the industry  
14 than some other types of mortgages, but this was fully  
15 disclosed obviously to the investors, the nature of the loans  
16 that were being made.

17 But anyway their argument is there are pervasive  
18 breaches, and therefore they are no longer obligated to follow  
19 what the contract says. The contract says their sole remedy  
20 for breaches that materially and --

21 THE COURT: Why don't you read me that sentence.

22 MR. MURPHY: Your Honor, the repurchase protocol  
23 starts at page 60 of the purchase and sale agreement. That is  
24 in the Court's file appended to the declaration of Cameron  
25 Matheson that was filed on February 6, 2013. It is Exhibit A.

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1 THE COURT: Was that part of the motion to dismiss on  
2 the face of the complaint?

3 MR. MURPHY: Yes.

4 THE COURT: Is that incorporated by reference into the  
5 complaint?

6 MR. MURPHY: It is. It absolutely is.

7 THE COURT: All of these affidavits are incorporated  
8 by reference?

9 MR. MURPHY: The declarations attached documents that  
10 were only documents that were specifically referenced in the  
11 complaint.

12 THE COURT: All right.

13 MR. MURPHY: So the repurchase protocol itself covers  
14 about two pages. That's page 60 -- page 62 of this Exhibit A  
15 to Mr. Matheson's declaration. If you go to page 62, it is  
16 2.04(b)(i) and it says that "It is understood and agreed that  
17 the obligation under this agreement of seller or the servicer  
18 to purchase or substitute any mortgage loan pursuant to Section  
19 2.01, 2.02 or 2.04(b) shall constitute the sole and exclusive  
20 remedy respecting a breach of the provision of Sections 2.01 or  
21 2.02," etc., etc.

22 What I would say, your Honor, is I don't believe that  
23 we have a dispute actually with AMBAC with respect to Count One  
24 of their complaint, which seeks repurchase of loans and that  
25 under that count they are bound by the sole remedy. They can

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1 speak for themselves, but that is my interpretation of their  
2 filing.

3 THE COURT: That is not their only claim.

4 MR. MURPHY: It is the other claims that they attempt  
5 to do an end run on this sole remedy provision. The important  
6 thing about the language is it does not say this sole remedy  
7 applies unless there are a lot of them, unless there are a lot  
8 of repurchases. They could have said that. They could have  
9 said a number of things. They didn't say that. They said if  
10 you want to enforce these reps and warranties you must follow  
11 this repurchase protocol, and they have to an extent with  
12 respect to 1286 loans. They haven't with respect to the rest.

13 So my first point is there is no exception for  
14 pervasive or there is a whole bunch of them.

15 THE COURT: Where does the expression pervasive come  
16 from?

17 MR. MURPHY: Simply from the complaint. That is their  
18 characterization of their findings.

19 My second point is simply that these documents, as the  
20 Court has already said, there was a whole lot of securitization  
21 activity going on, particularly in this time period we are  
22 talking about, which was 2006 and 2007, so it is a lot of  
23 securitization going on on Wall Street of mortgage loans. So  
24 what happened is there developed pretty much a standard set of  
25 documentation for these deals.

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1           So what we have here is fairly standard language  
2 across many, many deals. In particular it is standard language  
3 in the case Judge Rakoff decided last month, which is Assured  
4 v. Flagstar. Assured is a monoline financial guarantor, just  
5 like AMBAC, in exactly the same business, and they insured a  
6 deal. Flagstar was the originator of the loans in that deal,  
7 and they had the same documentation. They had this purchase  
8 and sale agreement and they had the insurance and indemnity  
9 agreement. And Assured made exactly the same arguments that  
10 AMBAC is making today on a motion to dismiss. Flagstar brought  
11 a motion to dismiss saying, your Honor, here at the outset of  
12 the case it's important that we establish that it is the sole  
13 remedy for what they are seeking.

14           And what they were seeking is the same. They sought  
15 indemnification, they sought reimbursement and all of that, and  
16 Judge Rakoff looked at both agreements, with virtually  
17 identical language, and determined that Assured could not  
18 pursue these other claims because they had agreed to the sole  
19 remedy.

20           So he rejected --

21           THE COURT: What is the sole remedy under your  
22 interpretation?

23           MR. MURPHY: Repurchase of loans.

24           So he rejected an indemnification claim, he rejected a  
25 reimbursement claim, and those are Count Four and Count Five in

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1 this complaint. It's the same. The analysis is the same. So,  
2 while this court certainly is not bound by Judge Rakoff, what I  
3 would simply say is Judge Rakoff has explained the analysis far  
4 better than I can do standing up today, and I would simply ask,  
5 we have dumped a lot of paper on the Court and I apologize for  
6 that, but if the Court could read a few cases --

7 THE COURT: Of course. I read everything you cite.

8 MR. MURPHY: I would put this at the very top. That  
9 is the decision on the motion to dismiss which was --

10 THE COURT: All right. Thank you. I will hear now  
11 from the other side.

12 MR. MURPHY: Your Honor, there was a second issue  
13 about whether all of the loans are at issue in this case or  
14 simply the ones for which they have given notice. Would you  
15 like me to address that one as well?

16 THE COURT: I will come back to you.

17 MR. MURPHY: OK.

18 MR. TOMLINSON: Good morning, your Honor. Peter  
19 Tomlin son from Patterson Belknap, and I represent both of the  
20 plaintiffs in this case AMBAC Assurance Corporation and the  
21 Segregated Account.

22 THE COURT: All right. Is it your position that this  
23 is an ambiguous contract?

24 MR. TOMLINSON: No, your Honor. I think it's actually  
25 quite clear. Mr. Murphy glosses over what AMBAC's claim is.

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1 He spent a substantial amount of time talking about the pooling  
2 and servicing agreement. He's right, that we don't disagree  
3 that in the pooling and servicing agreement there are specific  
4 loan-level representations that are about the individual  
5 mortgage loans. These are important representations that say  
6 that Chevy Chase Bank originated the loans in accordance with  
7 the underwriting guidelines, that there was no fraud committed  
8 in connection with the origination of these mortgage loans.  
9 These are specific loan-by-loan representations. In our  
10 complaint we call them the loan-level representations.

11 For breach of the loan-level representations, he read  
12 you what the parties referred to as the repurchase protocol.  
13 So if you have, you know, we have 12,000 loans here in six  
14 transactions, and if you have loans that don't comply with the  
15 specific representations, there is a repurchase protocol.  
16 Mr. Murphy read you the language. He glossed over the very  
17 statement about what the sole remedy -- I don't know if you  
18 still have it in front of you, page 62 of the PSA.

19 THE COURT: Just a moment.

20 MR. TOMLINSON: (i).

21 THE COURT: Yes. I have it in front of me.

22 MR. TOMLINSON: "It is understood and agreed that the  
23 obligations under this agreement of the seller or servicer,"  
24 which is Chevy Chase Bank, now known as Capital One, "to  
25 purchase or substitute any mortgage loan pursuant to Sections

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1 2.01, 2.02 or 2.04(b) shall constitute the sole and exclusive  
2 remedy respecting a breach of the provisions of Section 2.01 or  
3 2.02 or the representations and warranties set forth in Section  
4 2.03 and 2.04."

5 Our complaint contains other breaches, contained  
6 allegations of breaches of very important representations that  
7 AMBAC obtained in a separate agreement, which is the insurance  
8 and indemnity agreement, which is Exhibit B to the Matheson  
9 affirmation.

10 I don't know if it would be helpful, your Honor. I  
11 have a little one page document that has the provisions I am  
12 talking about. You can also follow along in there, but if you  
13 want, I'm happy to hand this up.

14 THE COURT: Very well.

15 MR. TOMLINSON: I have one for Mr. Murphy and  
16 Mr. Goldfarb, too.

17 THE COURT: I think I have something similar, but I  
18 will take yours.

19 MR. TOMLINSON: So in connection with the transaction,  
20 Mr. Murphy gave you a little background on AMBAC's role in the  
21 transaction.

22 While I was interested to hear that Chevy Chase dates  
23 back to the 19th century, I don't really think that has much to  
24 do with anything on this motion to dismiss, and we have alleged  
25 in our complaint basically a wholesale abandonment of mortgage



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1 underwriting in the 12,000 loans in these six transactions that  
2 have performed horribly. The transactions are going to suffer  
3 hundreds of millions of dollars in losses.

4 Chevy Chase Bank made very detailed representations  
5 both about the specific loans in the transaction and also about  
6 its practices to AMBAC. What the events of the last few years  
7 have shown is not there was a financial crisis that caused a  
8 lot of people to default on the mortgages, obviously there was  
9 a financial crisis, but what has come to light is that banks  
10 like Chevy Chase Bank, maybe they were prudent underwriters in  
11 the late 1800s, but in the 2005, 2006, 2007 era the speed at  
12 which they underwrote mortgages, issued mortgages to make  
13 profits doing securitizations, we see a wholesale abandonment  
14 of mortgage underwriting.

15 That's what our complaint is about, the losses. He  
16 did refer to a chart in our complaint. If you actually look  
17 at, I think it is on page 26 of our complaint, there is a chart  
18 of the default rates. These numbers may be a little outdated  
19 because they were at the time we filed the complaint, but in  
20 one of the transactions over 35 percent of the loans in this  
21 transaction were severely delinquent, liquidated or in  
22 foreclosure. So that is a huge percentage.

23 THE COURT: Unfortunately, that was all over the  
24 place.

25 MR. TOMLINSON: Yes.

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1           Now Mr. Murphy makes the point that, oh, well Chevy  
2 Chase Bank is better than the others. Again, on a motion to  
3 dismiss I don't real --

4           THE COURT: That's not the point. Right.

5           MR. TOMLINSON: That is not our point. We are only  
6 suing them for hundreds of millions of dollars, not billions of  
7 dollars, maybe because their loans aren't as bad as the others.  
8 It is like a child saying, oh, I am not as bad as some other  
9 kids. I don't think that is relevant on this motion to  
10 dismiss, but I don't want to digress any further. I want to go  
11 back to AMBAC's contract claims.

12           In the handout that I gave you, there is on the first  
13 page we have put what we called the transaction-level  
14 representations.

15           THE COURT: Just one moment.

16           Which document are you asking me to look at?

17           MR. TOMLINSON: The one I handed up. It says "Chevy  
18 Chase 2007-1" on the top.

19           THE COURT: Yes.

20           MR. TOMLINSON: What we have excerpted on the first  
21 page, and these are just excerpts from the documents attached  
22 to Mr. Matheson's affidavit, are from the insurance and  
23 indemnity agreement. In connection with this transaction, and  
24 I think both parties are using 2007-1 as the example, the  
25 relevant --

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1 THE COURT: Aren't you suing for repurchase?

2 MR. TOMLINSON: We are suing for repurchase, and we  
3 are also suing for breach of the insurance and indemnity  
4 agreement. And the insurance and indemnity agreement was an  
5 agreement between AMBAC and Capital One. Whereas AMBAC is not  
6 actually a party to the PSA that Mr. Murphy referred to, we are  
7 a third-party beneficiary, and we certainly have the rights  
8 under the PSA. But my client got important substantive rights  
9 in the insurance and indemnity agreement, and they got  
10 representations. We call these the transaction-level  
11 representations; because these don't relate to the individual  
12 one-off loans, these relate to the transaction as a whole.

13 These are in an agreement signed by Capital One in  
14 which they make, some of the representations are here. For  
15 instance, under 2.01(k), the private placement memorandum does  
16 not contain any untrue statement of material fact. It does not  
17 omit to state a material fact necessary to make the statements  
18 made therein in light of the circumstances under which they  
19 were made not misleading.

20 Each deal has a private placement memorandum. And the  
21 private placement memorandum -- and we allege this in our  
22 complaint I think at paragraph 38 -- contains statements about  
23 Chevy Chase's mortgage practices. For instance, it says the  
24 loans in the transaction were originated generally in  
25 accordance with Chevy Chase's underwriting guidelines.

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1           These are important points for AMBAC. AMBAC is taking  
2           on the risk of insuring the cash flows from six residential  
3           mortgage-backed securities transactions. Yes, they have the  
4           right to put loans back, to demand repurchase of loans that  
5           don't comply. I think Judge Crotty used the phrase, that is  
6           good for onesies and twosies.

7           AMBAC has that right. They don't dispute that AMBAC  
8           that is that right. They say that is all AMBAC can do. They  
9           try and shoehorn all of AMBAC's contract claims into the  
10          loan-level representations.

11          But the fact is AMBAC got different representations  
12          that were substantive and important to AMBAC, and the paragraph  
13          from the INI at the bottom, 3.01(i), actually makes clear that  
14          these representations that we call the transaction-level  
15          representations were actually a condition precedent to AMBAC  
16          issuing the policy.

17          So AMBAC issued the policy on the condition that these  
18          representations and warranties were true. So we got a  
19          representation that the information in the private placement  
20          memorandum contains a detailed discussion of how they originate  
21          mortgages.

22          There is also an accuracy-of-information  
23          representation. They provided us a lot of information about  
24          the mortgages, and they represented in that representation that  
25          that information is materially accurate.

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1 Yet we see systemic, as we have alleged in our  
2 complaint, a wholesale abandonment of underwriting guidelines,  
3 systemic problems with Chevy Chase's mortgage underwriting. So  
4 those we allege in our complaint are breaches of the  
5 transaction-level representations.

6 So the issue on the motion, your Honor, is whether  
7 that claim for breach of those representations is limited to  
8 the repurchase protocol, which is in a different agreement,  
9 which is in the PSA.

10 If you turn to the next page of my handout, simply at  
11 the top we have just recopied the sole remedy provision from  
12 the PSA. There you see it's very specifically the language in  
13 there says that it is the sole and exclusive remedy respecting  
14 a breach of provisions of Section 2.01 or 2.02 or of the  
15 representations.

16 THE COURT: 2.03 and 2.04?

17 MR. TOMLINSON: Yes. And those are the loan-level  
18 representations in the PSA. Those are not the  
19 transaction-level representations that form the basis of our  
20 breach of the material breach of the insurance indemnity  
21 agreement. I mean, it would have been very easy if the parties  
22 had wanted to limit AMBAC's remedy for the breach of the INI  
23 provisions to the PSA repurchase protocol to just say so. It  
24 doesn't say that.

25 The sole remedy provision from the PSA is actually

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1 repeated in the insurance and indemnity agreement. That's  
2 where I have 2.01(1), right underneath it.

3 So here we are now in the insurance and indemnity  
4 agreement, and it repeats the sole remedy provision. But,  
5 again, it says the remedy for any breach of any representation  
6 and warranty of Chevy Chase in Section 2.04 of the pooling and  
7 servicing agreement. It doesn't say for any breach of a  
8 representation and warranty about a loan or any breach of any  
9 representation in the insurance and indemnity agreement.

10 It doesn't say that. It could have said that. But it  
11 very clearly limits AMBAC's remedies for breach of Section  
12 2.04. And our claim for material breach of contract is not  
13 based on Section 2.04 of the PSA, and this sole remedy does not  
14 apply.

15 Mr. Murphy talked at length about the Flagstar  
16 decision by Judge Rakoff. That is actually an important  
17 decision on various points in the motion today. It is true  
18 that Judge Rakoff did hold that Assured's sole remedy was the  
19 loan-by-loan repurchase. But Assured in that case did not make  
20 this argument about the transaction-level representations and  
21 warranties, and based on my review of the complaint they didn't  
22 even allege that claim.

23 So our position is that decision is not on point. It  
24 does not involve allegations of breaches of representations and  
25 warranties in a separate contract. Taken to its extreme,

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1 Capital One's argument, we get these important representations  
2 in the insurance and indemnity agreement but we don't have any  
3 remedy for them, we already had the loan-by-loan repurchase  
4 remedy in the PSA. We went ahead and issued the policy as a  
5 result of getting the insurance and indemnity agreement. And  
6 now he says, Oh, by the way, your remedy for that is only the  
7 loan-by-loan repurchase protocol.

8 The kicker is that we have put back nearly 1,300 loans  
9 through the repurchase protocol. They haven't bought back a  
10 single one. And in their letters responding to us they  
11 actually said what we are saying. They said, Oh, the  
12 loan-by-loan repurchase protocol is not intended for bulk  
13 repurchase demands. You put back too many. It was never  
14 intended for this.

15 Frankly, that is something else we agree on, that the  
16 loan-by-loan repurchase protocol, as Judge Crotty said, for  
17 onesies and twosies, if you have a few loans that don't comply,  
18 you can use that.

19 What we have here are six lemons. The whole deal is a  
20 lemon, thousands and thousands of breaching loans. Our breach  
21 rate is nearly 87 percent. We had a statistician take 400  
22 loans, statistically select 400 loans from each transaction,  
23 and I think 87 percent on average between all six transactions  
24 breached the representations and warranties.

25 We used the repurchase protocol, and they didn't buy a

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Argument

1 single one. And here they are today telling your Honor that is  
2 our only remedy.

3 That is all I have, your Honor, on the sole remedy,  
4 unless you have any specific questions.

5 THE COURT: No.

6 What else do you want to talk to me about besides sole  
7 remedy. Let's put that aside.

8 MR. MURPHY: Could I take two minutes to respond to  
9 what was said there.

10 We have never agreed that they are relieved of the  
11 sole remedy, the repurchase protocol. They waited years after  
12 these deals were done to submit all of these repurchase  
13 demands, and what we received, your Honor, and this is in the  
14 record, they referenced letters.

15 THE COURT: Is this alleged in the complaint?

16 MR. MURPHY: Yes. They referenced letters.

17 THE COURT: Why don't you read me from the complaint  
18 what it says. That is what happens with prolix complaints.  
19 They read like novels instead of complaints.

20 MR. MURPHY: Your Honor, there is a reference to the  
21 back and forth about this repurchase protocol. Mr. Tomlinson  
22 referenced the response. We put in the response. It is in the  
23 complaint. I will give you the citation to where they quote,  
24 they cite having received the responses.

25 We put in the letter so you could see it, because this



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Argument

1 is my concern, is that --

2 THE COURT: What do you mean you put in the letter?

3 MR. MURPHY: We put --

4 THE COURT: The letter is not on the face of the  
5 complaint.

6 MR. MURPHY: They referenced that they received the  
7 letter and that we did not repurchase a loan.

8 THE COURT: Their allegation is that you didn't  
9 repurchase, right?

10 MR. MURPHY: Right. Exactly.

11 THE COURT: You don't need the letter for repurchase.

12 MR. MURPHY: We thought it was appropriate to put in  
13 the letter, since it is specifically relied upon in the  
14 complaint.

15 THE COURT: Well, you have an awful lot of stuff here.

16 MR. MURPHY: We do. It is attached to the second  
17 Cameron Matheson affidavit submitted in connection --

18 THE COURT: We don't usually get so many affidavits on  
19 complaints. That's because we have such prolix complaints.

20 MR. MURPHY: Some of the complaints that have been  
21 filed in cases actually attach all this documentation. This  
22 one did not.

23 THE COURT: I know they do. It is a real question as  
24 to whether they are appropriate.

25 MR. MURPHY: The letters, your Honor, give the Court a

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Argument

1 flavor for what we are dealing with here.

2 THE COURT: I understand. But a complaint should  
3 state a claim, not give a flavor.

4 MR. MURPHY: The letters, your Honor, these pervasive  
5 breaches, the letters show you what we are actually talking  
6 about here. One of the loans the criticism is that the  
7 borrower took out \$3,000 at closing and the guidelines only  
8 permitted \$2,000.

9 THE COURT: Why did they permit the \$3,000?

10 MR. MURPHY: Their math was wrong. It is explained in  
11 the letter. They took out \$1700.

12 THE COURT: I see. So a mistake was made on some  
13 loan.

14 MR. MURPHY: Another one, we are missing the HUD-1  
15 statement. The loan can't close without a HUD-1 statement.

16 THE COURT: What is the significance of that?

17 MR. MURPHY: I am just -- they referenced the letters.  
18 The letters show that what really happened is pervasive demands  
19 for repurchase that have absolutely no basis whatsoever.

20 The other thing that happened in the letters is we  
21 asked for information to support the repurchase demand and they  
22 did not provide it.

23 We further asked let's have a meeting to sit down and  
24 talk about your position on these loans and our position on  
25 these loans and resolve it. That's why there's this repurchase

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Argument

1 protocol. Because one thing the lawyers --

2 THE COURT: Why don't you do that now. Why don't you  
3 sit down together and work something out?

4 MR. MURPHY: I think it's a great idea. This is the  
5 thing that the lawyers did right, your Honor. They said, let's  
6 not run to Court about repurchase demands. Let's have this  
7 protocol where there's some back and forth and some time and  
8 this condition precedent that you do this before you run to  
9 Court. So we did our part, even though we've got some of the  
10 most astounding demands I've ever seen. Like, for instance, --

11 THE COURT: Well, the more we get into all of this  
12 nitty gritty --

13 MR. MURPHY: There are hundreds of them.

14 THE COURT: -- the less obvious anything is on the  
15 face of the complaint.

16 MR. MURPHY: There are hundreds of them. Hundreds.  
17 That is why we didn't buy back the loans.

18 The second issue is what are the loans at issue in  
19 this case.

20 By the way, all of the arguments articulated about  
21 sole remedy issue were very, very well stated. AMBAC's  
22 position is very well stated. These are actually the arguments  
23 Judge Rakoff dealt with. He dealt with that agreement.

24 THE COURT: I am aware that you consider Judge  
25 Rakoff's opinion something I should follow.

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Argument

1 MR. MURPHY: OK.

2 The second issue is what are the loans at issue in  
3 this case. Are they the loans for which they actually gave  
4 some notice, or is it the vast unknown of thousands of other  
5 loans? That issue was specifically addressed in a federal  
6 case --

7 THE COURT: Are you telling me that the complaint  
8 lacks specificity? Is that what you are saying?

9 MR. MURPHY: No, your Honor. I am saying that it is a  
10 condition precedent to suing Capital One that you follow this  
11 repurchase protocol, which begins with a notice of here are the  
12 loans we believe have breached and here's why. They didn't do  
13 that except for 1286 loans.

14 Just so I'm clear, we are not seeking to dismiss this  
15 entire case. We understand that there are 1286 loans at issue.

16 They disagree. They say that now all of the loans are  
17 at issue because they follow the protocol with respect to 1286.

18 The contract doesn't say that. The contract creates  
19 no exception for following the protocol. And so there is a  
20 developing area of the law.

21 THE COURT: So you are saying that the complaint seeks  
22 more than the plaintiff is entitled to. But how about the part  
23 that is sought that you think is appropriate?

24 MR. MURPHY: What I think is appropriate, we are not  
25 moving to dismiss Count One with respect to 1286 loans for

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Argument

1 which they have given notice. We are not moving to dismiss  
2 that. We are moving to dismiss the other counts and the  
3 concept of including an unknown thousand number of loans for  
4 which we were not given notice. This precise issue was  
5 addressed last year in the federal court in Minnesota in a case  
6 called Master Asset Backed Services v. WMC, 843 F.Supp.2d 996.

7 And there, exactly the same situation. The plaintiff  
8 gave notice about 150 loans. They did a sample. They've done  
9 a sample. Plaintiff there did a sample of 200 loans, and they  
10 demanded repurchase of 150 of them, and they took the position  
11 that now all of the loans are at issue.

12 I said before that the transaction documents are  
13 pretty standard. What the Court will see in reading that case  
14 is we are talking about pretty much actually the same  
15 documents. There it said the sole remedy of repurchase, and  
16 there is this repurchase protocol.

17 The judge said, Plaintiff, you have given notice of  
18 150 loans only. This case is going to be about those 150 loans  
19 and all of your other claims related to other loans in the deal  
20 are dismissed.

21 It wasn't summary judgment, it wasn't trial, it was a  
22 motion to dismiss. The Court determined this is going to be a  
23 case about those loans where you followed the protocol. And  
24 that case, we submit, was properly decided on documentation.

25 THE COURT: That is a different issue.

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Argument

1 MR. MURPHY: It is. That is the second issue.

2 THE COURT: You are now arguing that under the  
3 contract they were required to give you notice of which loans  
4 they wanted repurchase of?

5 MR. MURPHY: Right.

6 THE COURT: And they have failed to do that?

7 MR. MURPHY: That is correct.

8 THE COURT: And therefore are not entitled to  
9 repurchase?

10 MR. MURPHY: That's right. Until such time as they  
11 have given notice.

12 THE COURT: Let me hear your adversary on that.

13 Why is that not a basis for dismissal?

14 MR. TOMLINSON: First, your Honor, this is only  
15 relevant to the loan repurchase claim.

16 THE COURT: Let's stay for a moment with the loan  
17 repurchase claim.

18 MR. TOMLINSON: The short answer is, your Honor, we  
19 have alleged that Capital One is on constructive inquiry notice  
20 of the widespread and wholesale breaches in the six pools, and  
21 we do that in the complaint.

22 THE COURT: What does the contract say about notice?

23 MR. TOMLINSON: We do that at paragraph 45, your  
24 Honor, of our complaint.

25 The contract, the PSA on notice says that upon

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Argument

1 discovery by Chevy Chase and various, and us, or the trustee,  
2 they are supposed to give prompt notice to the other parties.  
3 Chevy Chase here --

4 THE COURT: So it is your position that was not your  
5 sole obligation?

6 MR. TOMLINSON: Yes.

7 THE COURT: Or you alone were not obliged; that the  
8 defendant made the same mistake?

9 MR. TOMLINSON: The defendant originated these loans,  
10 they serviced these loans. They are much closer to these loans  
11 than we are.

12 They have the loan files. They know what they did  
13 with their loan practices in 2006 and 2007. The fact that we  
14 put back 1,300 loans from six transactions puts them on  
15 constructive notice that there are widespread deficiencies in  
16 this pool.

17 There is a case that is directly on point, and it is  
18 actually Mr. Murphy's favorite case, which he didn't mention  
19 here. It is Assured v. Flagstar. Judge Rakoff considered,  
20 after finding that Assured's sole remedy was the loan put-back,  
21 Flagstar said, well, it can only be the loans that have been  
22 put back. Judge Rakoff specifically rejected that and said,  
23 "The material uniformity of the underlying loan population" --  
24 let me just cut to the chase. "Notification to Flagstar of  
25 pervasive breaches affecting charged-off loans that were the

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Argument

1 subjects of Assured's internal review render Flagstar  
2 constructively aware or at a minimum put Flagstar on inquiry  
3 notice of substantial likelihood that these breaches extended  
4 beyond the charged-off loan population."

5 Judge Rakoff then allowed Assured to do sampling.  
6 Mr. Murphy's approach is we are going to have to do this  
7 loan-by-loan, death by a thousand cuts. We have done 1,286,  
8 and they haven't repurchased a single one.

9 Also, given the approach that Capital One has taken  
10 it's also a futile remedy. So we have given notice with  
11 respect to 1286, and we have alleged in our complaint that they  
12 are on constructive notice that these six pools are replete  
13 with nonconforming loans, and under Assured v. Flagstar that is  
14 sufficient at this stage of the case.

15 MR. MURPHY: Very, very briefly, your Honor.

16 Our motion in the Flagstar case disposes of counts  
17 Three and Four and Five. I haven't spoken about Count Two,  
18 which is they allege a breach of the repurchase protocol, which  
19 is a remedy.

20 They allege there is a breach of the remedy because we  
21 haven't bought back loans, and therefore they can sue for  
22 damages. That remedy is for repurchase, whether the seller has  
23 repurchased the loans or not. It's a remedy. It is not an  
24 independent basis for a claim.

25 They have cited three cases, not in New York, to



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Argument

1 support the idea that they can somehow sue on the remedy and  
2 convert the sole remedy of repurchase into a damages case. I  
3 am not articulating it well only because it doesn't make any  
4 sense.

5 They cite three cases. One is La Salle Bank, district  
6 of Maryland -- no New York cases here -- and this says, the  
7 district court case says, "Under New York law a loan seller's  
8 failure to repurchase nonconforming loans upon demand is an  
9 independent breach."

10 That's their position, and that's what they rely on.

11 In their brief they cite that case. There's no New  
12 York cases cited in that District of Maryland case.

13 THE COURT: I understand, but that District of  
14 Maryland case was under New York law.

15 MR. MURPHY: It wasn't.

16 THE COURT: I see. Then how is it that New York law  
17 was recited?

18 MR. MURPHY: It is a fascinating story. In their  
19 brief where they cited that language, which is pretty absolute  
20 in supporting their position, there's parents "citation  
21 omitted." There is a citation in there. And it is a citation  
22 to a First Circuit case called Resolution Trust, a First  
23 Circuit case.

24 THE COURT: They were not applying New York law either  
25 in the First Circuit?

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Argument

1 MR. MURPHY: The First Circuit said, whether or not  
2 he, the defendant, committed an independent breach by failing  
3 to repurchase on demand, the district court was free to make  
4 the purchaser whole, and it did so in terms of the obligations  
5 imposed by the contract.

6 The First Circuit said whether or not there is an  
7 independent breach here. The District of Maryland cited that  
8 case, and to me it is an example of why it's really important  
9 to hire really good clerks. Because they converted that First  
10 Circuit decision into --

11 THE COURT: Never mind really good clerks. You are  
12 suggesting the judge doesn't read the opinions.

13 MR. MURPHY: All I know is what it says in the  
14 complaint.

15 Under New York law a loan seller's failure to  
16 repurchase nonperforming loans upon demand is an independent  
17 breach. We cite Resolution Trust, First Circuit, and that case  
18 doesn't say that and New York law has never said that. There's  
19 no New York Court of Appeals case cited by anybody, there is no  
20 Second Circuit case, it is wrong. It is a remedy to say that  
21 there is a breach of the repurchase remedy, and when that  
22 happens, I am relieved of the sole remedy that we agreed to of  
23 repurchase. That's gone, and now I can sue for damages. It  
24 doesn't make any sense, and that's why there's no authority to  
25 support that idea.

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Argument

1 MR. TOMLINSON: I will be brief, your Honor.

2 Our position is it is very clear that the contract has  
3 an independent covenant that says in the event that there is a  
4 loan that doesn't comply with the loan-level representations  
5 and warranties, Capital One is obligated to repurchase that  
6 loan if it materially and adversely affects the interest of the  
7 insured.

8 That is a term in the contract. That is a covenant in  
9 the contract. We allege that they have breached it. We have a  
10 breach of contract for breach of the repurchase protocol.

11 I think the Arkansas case from 2012 the Eastern  
12 District of Arkansas case involving Lehman, which I had a  
13 chance to look at very briefly, very clearly is applying New  
14 York law and holds exactly that.

15 I haven't had a chance to reread the Resolution Trust  
16 case after Mr. Murphy's point, but I think it is as simple as  
17 that. It is a separate covenant in the contract. We have  
18 alleged a breach of it, and that is a separate breach of  
19 contract claim. He says there is no New York Court of Appeals  
20 authority on point supporting our position, but he really  
21 doesn't rely on anything.

22 Your Honor, I won't go into the reimbursement and  
23 indemnification claims. There are separate claims. Our  
24 position is they are not governed by the sole remedy. I think  
25 our position is set forth in the briefs, but he mentioned them

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Argument

1 briefly so I just wanted to refer your Honor to the brief.

2 THE COURT: I take it that your position is that the  
3 provision on sole remedy doesn't apply to a lot of this?

4 MR. TOMLINSON: Yes. It applies to what it says it  
5 applies to: Breaches of Section 2.04 of the PSA. It is the  
6 sole remedy for that.

7 There is a whole section of the INI called  
8 reimbursement claim, so why would there be a section of the  
9 insurance indemnity agreement called AMBAC's reimbursement  
10 right if AMBAC's only remedy was the loan-by-loan repurchase.

11 Judge Rakoff in Flagstar actually awarded Assured  
12 reimbursement of its attorney's fees under the reimbursement,  
13 even though he had found that the sole remedy for the loan  
14 put-backs was the repurchase protocol.

15 We actually have two bases for our reimbursement  
16 claim. We have one, the legal fees for this action in putting  
17 back all the loans, and there is a separate prong of the  
18 reimbursement provision here that actually provides that AMBAC  
19 can get its claims payments back for failure of Capital One to  
20 remove loans from the transactions. I think that is all set  
21 forth in our paper, but that is a separate claim that AMBAC is  
22 entitled to under the clear language of the INI.

23 THE COURT: And both sides here want to argue that  
24 this is an unambiguous contract?

25 MR. TOMLINSON: We think it is clear, your Honor. It

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Argument

1 is a motion to dismiss, and if your Honor decided that it is  
2 not clear, we could have discovery on it. But we think the  
3 sole remedy provision is clear on its face, that it does not  
4 apply to our transaction-level claims or indemnification claim  
5 or our reimbursement claim.

6 MR. MURPHY: Your Honor, with respect to the issues  
7 raised on the motion, it is our position that those are not  
8 ambiguous in any way and are very clear.

9 Two quick points. He mentioned a District of Arkansas  
10 case. There is no mention of a sole remedy. So while I said  
11 documentation is standard, there is no mention in that case of  
12 what we are talking about here, the sole remedy provision.

13 Secondly, all of these other remedies are dealt -- the  
14 idea stems from this 5.02 of the insurance and indemnification  
15 agreement. 5.02(b) starts with this provision, your Honor,  
16 "Unless otherwise expressly provided, no remedy herein  
17 conferred is intended to be exclusive."

18 Well, we showed you the language where it said  
19 precisely --

20 THE COURT: It doesn't say exclusive.

21 MR. MURPHY: It does say exclusive.

22 THE COURT: Why don't you read me the language again.

23 MR. MURPHY: This is page 62.

24 THE COURT: Yes. But you have to include the sections  
25 that it mentions.

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Argument

1 MR. MURPHY: Correct.

2 That is correct, your Honor.

3 Just so my position is clear, there are other  
4 representations in the insurance and indemnity agreement that  
5 provide for obligations of Chevy Chase Bank, now Capital One,  
6 postclosing for instance. Like they have the right to  
7 information. They have the right to financial information.  
8 They have the right to servicing information. They have a  
9 number of rights.

10 They haven't sued on those. Those don't have to do  
11 with the loans. The loans and claims based on the loans and  
12 alleged improperly underwriting of the loans have a sole  
13 remedy.

14 When they say look at the private placement  
15 memorandum, it says that the loans were properly underwritten.  
16 What Judge Rakoff said is, you can't end run the sole remedy by  
17 saying, Hey, I've got this representation in the insurance and  
18 indemnity agreement which deals with the underwriting of loans  
19 and, therefore, I get to sue for damages and forget about the  
20 sole remedy.

21 Judge Rakoff ruled you've got to look at these two  
22 agreements together and reconcile them, and claims based on  
23 there's something wrong with the loans are subject to the sole  
24 remedy.

25 THE COURT: Very commonly when you have to do so much

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Argument

1 reconciling, the contract is not unambiguous.

2 But I understand all of the positions all of you take,  
3 and I reserve decision.

4 MR. MURPHY: Thank you, your Honor.

5 MR. TOMLINSON: Thank you, your Honor.

6 THE COURT: You are all excused.

7 (Adjourned)

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